

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF DEXTER-ALMO)	CASE NO.
HEIGHTS WATER DISTRICT FOR ALTERNATIVE)	2019-00354
RATE ADJUSTMENT)	

NOTICE OF FILING OF STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of January 15, 2020, the attached report containing the findings of Commission Staff regarding the Applicant's proposed rate adjustment has been filed in the record of the above-styled proceeding. Pursuant to the Commission's January 15, 2020 Order, Dexter-Almo Heights Water District is required to file written comments regarding the findings of Staff no later than 14 days from the filing of this Report.



Kent A. Chandler
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATE MAR 02 2020

cc: Parties of Record

STAFF REPORT
ON
DEXTER-ALMO HEIGHTS WATER DISTRICT
CASE NO. 2019-00354

Dexter-Almo Heights Water District (Dexter-Almo Heights District), a water district organized pursuant to KRS Chapter 74, provides water service to approximately 818 residential and commercial customers residing in Calloway County, Kentucky.¹ On October 14, 2019, Dexter-Almo Heights District tendered an application (Application) to the Commission requesting to adjust its water rates pursuant to 807 KAR 5:076, and it was accepted as filed. To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated November 13, 2019. Staff issued a data request on January 15, 2020, to collect additional information regarding Dexter-Almo Heights District's financial records. Finding the Dexter-Almo Heights District would need additional time to respond to the data request, the Commission issued an Order on January 15, 2020, amending its November 13, 2019 Order, and allowing for additional time for Dexter-Almo Heights District to respond and to allow Staff to complete this report.

To comply with the requirements of 807 KAR 5:076, Section 9,² Dexter-Almo Heights District used the calendar year ended December 31, 2018, as the basis for its Application. Using its pro forma test-year operations, Dexter-Almo determined that a revenue increase of \$67,546, or 24.14 percent, over test-year normalized revenues of \$279,862 is warranted as

¹ *Annual Report of Dexter-Almo Heights Water District to the Public Service Commission for the Calendar Year Ended December 31, 2018* (2018 Annual Report) at 12 and 38.

² The reasonableness of the proposed rates shall be determined using a 12-month historical test period, adjusted for known and measureable changes, that coincides with the reporting period of the applicant's annual report for the immediate past year.

shown in the table below.³ The rates requested by Dexter-Almo Heights District would increase the monthly bill of a typical residential customer using 3,790 gallons per month by \$6.83, from \$28.25 to \$35.08, or approximately 24.18 percent.

Revenue Requirement Determination - Operating Ratio Method	
Operating Expenses	\$ 305,626
Divided by: Operating Ratio	<u>88%</u>
Overall Revenue Requirement	347,302
Add: Interest Expense	2,526
Less: Other Operating Revenue	(2,025)
Non-operating Revenue	(359)
Interest Income	<u>(36)</u>
Revenue Requirement - Water Rates	347,408
Less: Normalized Revenue from Water Service	<u>(279,862)</u>
Required Revenue Increase	<u>\$ 67,546</u>
Percentage Increase	<u>24.14%</u>

To determine the reasonableness of the rates requested by Dexter-Almo Heights District, Staff performed a limited financial review of Dexter-Almo Heights District's test-year operations. The scope of Staff's review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable changes to test-year operations were identified and adjustments were made when their effects were deemed material. Insignificant and immaterial discrepancies were not pursued or addressed.

Staff's findings are summarized in this report. Travis Leach reviewed the calculation of Dexter-Almo Heights District's Overall Revenue Requirement. Jason Green reviewed Dexter-Almo Heights District's reported revenues and rate design.

³ Application, Exhibit B.

SUMMARY OF FINDINGS

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Operating Ratio Method, as generally accepted by the Commission, Staff found that Dexter-Almo Heights District's Overall Revenue Requirement to be \$346,734. A revenue increase of \$66,979, or 23.93 percent, is necessary to generate the Overall Revenue Requirement.

2. Monthly Water Service Rates. Dexter-Almo Heights District proposed to increase all of its monthly retail water service rates evenly across the board by approximately 24.14 percent. Dexter-Almo Heights District has not performed a cost-of-service study (COSS). The Commission has previously found that the allocation of a revenue increase evenly across the board to a utility's rate design is appropriate when there has been no evidence entered into the record demonstrating that this method is unreasonable and in the absence of a COSS. Finding no such evidence in this case, Staff followed the method proposed by Dexter-Almo Heights District and allocated the \$66,979 revenue increase across the board to Dexter-Almo Heights District's monthly retail water service rates.

The rates set forth in the Appendix to this report are based upon the revenue requirement, as calculated by Staff, and will produce sufficient revenues from water sales to recover the \$346,840 Revenue Required from Rates, an approximate 23.93 percent increase. These rates will increase a typical residential customer's monthly water bill from \$28.25 to \$35.01, an increase of \$6.76, or approximately 23.93 percent.⁴

3. Unauthorized Debt. Dexter-Almo Heights District provided a copy of the Promissory Note⁵ between itself and the Murray Bank of Calloway County, Kentucky (Murray

⁴ The typical residential customer uses approximately 3,790 gallons per month.

Bank), in the principal amount of \$145,988. This Promissory Note has an origination date of December 9, 2009, and a 15-year term. In Case No. 2006-00420 the Commission granted Dexter-Almo Heights District a Certificate of Public Convenience and Necessity to construct the Coles Campground Road Project and approved the proposed plan of financing, which included a \$47,613 line of credit with Murray Bank.⁶ In its November 23, 2005 letter, Murray Bank states that Dexter-Almo Heights District's total line of credit was for \$150,000, and that the line of credit was renewable on a two-year term.⁷

According to KRS 278.300, no utility shall issue any form of indebtedness unless it has been authorized to do so by an Order of the Commission.⁸ Dexter-Almo Heights District currently has an outstanding loan that is payable to the Murray Bank for which Dexter-Almo Heights District did not obtain Commission approval as required by KRS 278.300. The Commission has previously investigated and addressed the issue of the unauthorized indebtedness in Case No. 2017-00468.⁹

PRO FORMA OPERATING STATEMENT

Dexter-Almo Heights District's Pro Forma Operating Statement for the test year ended December 31, 2018, as determined by Staff, appears below.

⁵ Application, Loan_Documentation_1.pdf, Promissory Note.

⁶ Case No. 2006-00420, *Application of Dexter-Almo Heights Water District for (1) Issuance of a Certificate of Public Convenience and Necessity Authorizing the Construction of the Flint & Coles Campground Project No. Wx21035012; and (2) Approval of Its Proposed Plan of Financing the Project* (Ky. PSC Nov. 21, 2006) at 3.

⁷ *Id.*, November 23, 2005 Letter from Murray Bank (filed on Oct. 2, 2006).

⁸ This requirement does not apply to notes or loans with a two-year term. Those notes or loans can be renewed up to two times for a combined term that does not exceed six years. Dexter-Almo Heights District's Promissory Note has a 15-year term, and after ten years, it still has an outstanding balance.

⁹ Case No. 2017-00468, *Dexter-Almo Heights Water District and Its Individual Commissioners, Joe Dan Taylor, Charles Boren, and Pat Paschall Alleged Failure to Comply With KRS 278.300* (Ky. PSC June 19, 2019).

	2018 Annual Report	Pro Forma Adjustments		Pro Forma Operations
Operating Revenues:				
Revenues from Water Sales:				
Metered Water Sales:	\$ 275,034	4,827	(A)	\$ 279,861
Other Water Revenues:				
Other Water Revenues	0	2,025	(B)	2,025
Total Other Water Revenues	0	2,025		2,025
Total Operating Revenues	275,034	6,852		281,886
Operating Expenses:				
Operation & Maintenance:				
Salaries & Wages - Employees	55,042	1,157	(C)	56,199
Salaries & Wages - Commissioners	7,200			7,200
Employee Pension and Benefits	1,059			1,059
Purchased Water	130,138	7,534	(D)	135,593
		(2,079)	(E)	
Purchased Power	1,557	69	(F)	1,626
Materials and Supplies	31,532	(3,095)	(G)	28,437
Contractual Services	25,968	(3,000)	(H)	
		627	(I)	23,595
Water Testing	1,570	(627)	(I)	1,400
		457	(J)	
Tranportation Expense	6,300			6,300
Insurance	4,606	66	(K)	4,672
Miscellaneous Expense	6,176			6,176
Total Operation & Maintenance	271,148	1,109		272,257
Depreciation	25,913	(202)	(L)	25,711
Amortization Expense	0	2,061	(M)	2,061
Taxes Other Than Income	5,629	86	(N)	5,097
		(619)	(O)	
Utility Operating Expenses	302,690	2,436		305,126
Net Utility Operating Income	\$ (27,656)	\$ 4,416		\$ (23,240)

(A) Billing Analysis Adjustment. Dexter-Almo Heights District proposed to increase its test-year revenues from water sales of \$275,034 by \$4,827 to reflect the impact of the most recent purchased water adjustment (PWA) granted by the Commission.¹⁰ Applying the

¹⁰ Exhibit A, References, Item A.

approved PWA rates from Case No. 2018-00199¹¹ to Dexter-Almo Heights District's billing analysis, Staff calculated a normalized revenue of \$279,862. Accordingly, Staff has increased test year water sales revenue by \$4,827.

(B) Other Water Revenues. Dexter-Almo Heights District proposed to increase its test-year Other Water Revenues by \$2,025 to reflect reconnection fees that it misreported as nonutility income in its 2018 Annual Report. Staff finds that Dexter-Almo Height District's adjustment meets the ratemaking criteria of being known and measurable and accepts it in pro forma operations.

(C) Salaries and Wages. Dexter-Almo Heights District proposed to increase its test-year salaries and wages expense of \$55,042 by \$802 to reflect a raise received by one of their employees, as well as a new hire replacing a retired office manager.¹² The responses to the data request show that Dexter-Almo Heights District employs a full-time Manager/Operator, a full-time Office Manager, and a part-time Meter Reader as well as the salaries associated with these positions and changes in salaries and wages for these positions over the past five years. As shown below, Staff determined Dexter-Almo Heights District has increased pro forma Salaries and Wages – Employees expense by \$1,157 to reflect current staff salaries and wages.

¹¹ Case No. 2018-00199, *Purchased Water Adjustment Filing of Dexter-Almo Heights Water District* (Ky. PSC July 10, 2018).

¹² Schedule of Adjusted Operations, References, Item C.

<u>Full-Time Employees</u>	<u>Pro Forma Salary</u>
Manager/Operator	\$ 35,300
Office Manager	<u>13,000</u>
Pro Forma Full-Time Employee Salary Expense	<u>\$ 48,300</u>
<u>Part-Time Employee</u>	
Test Year Hours	831.5
Multiply By: Pro Forma Hourly Rate	<u>\$ 9.50</u>
Pro Forma Part-Time Wages Expense	<u>\$ 7,899</u>
<u>Pro Forma Salaries and Wages Adjustment</u>	
Pro Forma Salaried Employees Expense	\$ 48,300
Add: Pro Forma Hourly Employee Expense	<u>\$ 7,899</u>
Pro Forma Salaries and Wages Expense	\$ 56,199
Less: Test Year Salaries and Wages Expense	<u>(55,042)</u>
Pro Forma Salaries and Wages Adjustment	<u>\$ 1,157</u>

(D) Purchased Water. Dexter-Almo Heights District proposed to increase its test-year purchased water expense of \$130,138 by \$7,534 to reflect the impact of the increased wholesale water rate that occurred in 2018.¹³ Staff finds that Dexter-Almo Height District's adjustment meets the ratemaking criteria of being known and measurable and accepts it in pro forma operations, as explained below.

Changes to Wholesale Purchase Water Rate. Murray Municipal Utilities (Murray Utilities) increased its wholesale water rate in the test year.¹⁴ Staff is increasing test-

¹³ *Id.*, Item E-1.

¹⁴ Case No. 2018-00199, *Purchased Water Adjustment Filing of Dexter-Almo Heights Water District* (Ky. PSC July 10, 2018) (effective July 1, 2018, Murray increased its wholesale water rate to \$3.23 per 1,000 gallons).

year purchased water expense by \$7,534 to account for the wholesale rate of \$3.23 per thousand gallons that became effective on July 1, 2018.

Total Gallons	42,623
Multiply By: Pro Forma Purchased Water Price	<u>\$ 3.23</u>
Pro Forma Purchased Water Expense	137,672
Less: Test Year Purchased Water Expense	<u>(130,138)</u>
Pro Forma Purchased Water Expense Adjustment	<u><u>\$ 7,534</u></u>

(E) Excess Water Loss. Dexter-Almo Heights District proposed to decrease its test-year purchased water expense by \$2,079 to reflect the cost of purchasing excess water loss.

Commission regulation 807 KAR 5:066, Section 6(3), limits water loss to 15 percent, for ratemaking purposes unless the Commission finds an alternative level reasonable. In the below table, Staff determines Dexter-Almo Heights District’s test-year water loss was 16.51 percent, or 1.51 percent above the 15 percent allowable limit.

With the adjustments in the table below, Staff is removing from Dexter-Almo Heights District’s test-year operations the cost of purchasing the excess water loss.

<u>Account</u>	<u>Test Year</u>	<u>Times: Excess Water Loss</u>	<u>Pro Forma Adjustment</u>
Purchased Water	\$ 137,672	-1.51%	\$ (2,079)

(F) Purchased Power. Dexter-Almo Heights District proposed to increase its test-year Purchased Power expense by \$66 to reflect an increase in its electricity provider’s customer charge from \$25 to \$28.50 as well as a decrease to the usage charge of \$0.0025/KWh, effective October 1, 2019. Dexter-Almo Heights District has two locations with

electric meters, their office and a sump pump used to drain water from a pit located at Dexter-Almo Heights District's master meter. As shown below, Staff has increased test-year purchased power expense by \$69.

Pro Forma Monthly Customer Charge	\$ 28.25
Multiply by: 12 Months	12
Multiply by: 2 Locations	<u>2</u>
Pro Forma Total Customer Charge	678
Less: Test Year Total Customer Charge	<u>(600)</u>
Pro Forma Customer Charge Adjustment	<u>\$ 78.00</u>
Decrease in Usage Charge	\$0.00250
Multiply by: Test Year Usage (kWh)	<u>3,744</u>
Pro Forma Usage Adjustment	<u>\$ (9)</u>
Pro Forma Customer Charge Adjustment	\$ 78.00
Pro Forma Usage Adjustment	<u>(9)</u>
Total Pro Forma Purchased Power Adjustment	<u>\$ 69</u>

(G) Materials and Supplies. Dexter-Almo Heights District proposed to decrease its test-year Materials and Supplies expense by \$3,095 to reflect material and supply costs associated with test-year tap-ons. Staff finds that Dexter-Almo Height District's adjustment meets the ratemaking criteria of being known and measurable and accepts it in pro forma operations.

(H) Contractual Services – Tap-ons. Dexter-Almo Heights District proposed to decrease its test-year Materials and Supplies expense by \$3,000 to reflect contractor costs associated with test-year tap-ons. Staff finds that Dexter-Almo Height District's adjustment

meets the ratemaking criteria of being known and measurable and accepts it in pro forma operations.

(I) Contractual Service - Water Testing. Dexter-Almo Heights District proposed to increase its test-year Materials and Supplies expense by \$627 as well as decrease Water Testing expense by \$627 to reflect misclassification of meter testing and other testing expenses as Water Testing expense. Staff finds that Dexter-Almo Height District’s adjustment meets the ratemaking criteria of being known and measurable and accepts it in pro forma operations.

(J) Water Testing. Dexter-Almo Heights District proposed to increase its test-year Water Testing expense by \$457 to reflect an increase in the price of per sample water testing from \$23 to \$25, as shown below. Staff finds that Dexter-Almo Height District’s adjustment meets the ratemaking criteria of being known and measurable and accepts it in pro forma operations.

41 water samples x \$25 per sample	\$ 1,025
Add: Stage 2 HAA & TTHM Testing	<u>375</u>
Pro Forma Water Testing Expense	1,400
Less: Adjusted Test Year Water Testing Expense	<u>943</u>
Pro Forma Water Testing Expense	<u><u>\$ 457</u></u>

(K) Insurance. Dexter-Almo Heights District proposed to increase its test-year Insurance expense by \$66 to reflect an increase in premiums for worker’s compensation insurance, as shown below. Staff finds that Dexter-Almo Height District’s adjustment meets the ratemaking criteria of being known and measurable and accepts it in pro forma operations.

Test Year Workers Comp Insurance Expense	\$ 1,580
Less: Pro Forma Workers Comp Insurance Expense	<u>(1,646)</u>
Pro Forma Workers Comp Insurance Expense Adjustment	<u>\$ 66</u>

(L) Depreciation. The Commission has historically relied upon the report published in 1979 by the National Association of Regulatory Utility Commissioners (NARUC) titled Depreciation Practices for Small Water Utilities (NARUC Study). When no evidence exists to support a specific life that is outside the NARUC ranges, the Commission has historically used the mid-point of the NARUC ranges to depreciate the utility plant. In following with the Commission's historical practice of using the mid-point of the NARUC ranges to calculate depreciation, Staff finds that Dexter-Almo Heights District's test-year depreciation expense of \$25,913 should be decreased by \$202 to reflect the following:

Asset Account	Current:			Pro Forma:		
	Original Cost	Depreciation Expense	Life	Depreciation Expense	Difference	
1997 Building	\$ 19,952	\$ 599	37.5	\$ 532	\$ (67)	
2015 Storage Building	2,640	528	37.5	\$ 70	\$ (458)	
1986 Additions	3,677	74	37.5	\$ 98	\$ 24	
1993 Additions	3,602	72	37.5	\$ 96	\$ 24	
1964 Water Treatment Equipment	2,563	218	27.5	\$ 93	\$ (125)	
1989 Distribution	13,650	273	62.5	\$ 218	\$ (55)	
1994 Distribution	6,408	128	62.5	\$ 103	\$ (25)	
1964 Services	16,990	340	40.0	\$ 425	\$ 85	
1998 Hydrants	10,618	212	50.0	\$ 212	\$ 0	
2014 Hydrants	3,125	125	50.0	\$ 63	\$ (63)	
2015 Hydrants	4,825	193	50.0	\$ 97	\$ (97)	
2003 Copier	1,295	26	22.5	\$ 58	\$ 32	
2014 Computer	1,056	211	22.5	\$ 47	\$ (164)	
2012 Chevy Silverado	16,000	1,600	7.0	\$ 2,286	\$ 686	
				Pro Forma Adjustment	<u>\$ (202)</u>	

(M) Rate Case Expense. Dexter-Almo Heights District proposed to increase its test-year Amortization expense by \$2,000 to reflect the three-year amortization of the estimated \$6,000 rate case expense. In Dexter-Almo Heights District's First Supplement to

its Application, however, it adjusted this number to include known and measureable costs of \$5,427 for legal services and \$756 for publication of notice. Accordingly, Staff has increased test-year amortization expense by \$2,061, as shown below.

Rate Case Expense	\$6,184
Divide by: 3 years	<u>3</u>
Pro Forma Amortization Expense Adjustment	<u><u>\$2,061</u></u>

(N) Taxes Other Than Income – Commission Assessment. Dexter-Almo Heights District proposed to increase its test-year Taxes Other Than Income expense by \$87 to reflect an increase in the Commission Assessment resulting from greater operating revenues and a 2019 tax rate, as shown below. Staff finds that Dexter-Almo Height District’s adjustment meets the ratemaking criteria of being known and measurable and accepts it in pro forma operations.

Test Year Operating Revenues	\$ 279,861
Times: 2019 Tax Assessment Rate	<u>0.1956%</u>
Pro Forma Assessment Expense	547
Less: Test Year Assessment Expense	<u>(461)</u>
Pro Forma Assessment Expense Adjustment	<u><u>\$ 86</u></u>

(O) Taxes Other Than Income – Payroll Taxes. Dexter-Almo Heights District proposed to increase its test-year Taxes Other Than Income expense by \$93 to reflect an increase in payroll taxes associated with the increase in salaries and wages expense discussed above. However, upon application of a FICA tax rate of 7.65 percent, Staff calculated a decrease in pro forma payroll tax expense of \$619, as shown below.

Pro Forma Wages	\$ 56,199
Times: 7.65 Percent FICA Rate	<u>7.65%</u>
Total Pro Forma Payroll Taxes	4,299
Less: Test Year Payroll Taxes	<u>(4,918)</u>
Payroll Tax Adjustment	<u>\$ (619)</u>

OVERALL REVENUE REQUIREMENT AND REQUIRED REVENUE INCREASE

By applying the Operating Ratio Method, as generally accepted by the Commission, Staff found Dexter-Almo Heights District's Overall Revenue Requirement to be \$346,734. A revenue increase of \$66,979, or 23.93 percent, is necessary to generate the Overall Revenue Requirement.

The operating ratio methodology¹⁵ is used when there is no basis for a rate-of-return determination, the cost of the utility has fully or largely been funded through contributions, or there is little or no outstanding long-term debt. Staff is of the opinion that an operating ratio of 88 percent will allow Dexter-Almo Heights District sufficient revenues to cover its reasonable operating expenses and provide for reasonable equity growth. Therefore, Staff finds the Operating Ratio Method is more appropriate as Dexter-Almo Heights District has only one outstanding debt.

¹⁵ Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues. It is illustrated by the following equation:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

	Dexter-Almo Heights District	Staff
Operating Expenses	\$ 305,626	\$ 305,126
Divided by: Operating Ratio	<u>88%</u>	<u>88%</u>
Overall Revenue Requirement	347,302	346,734
Add: Interest Expense	2,526	2,526
Less: Other Operating Revenue	(2,025)	(2,025)
Non-operating Revenue	(359)	(359)
Interest Income	<u>(36)</u>	<u>(36)</u>
Revenue Requirement - Water Rates	347,408.27	346,840
Less: Normalized Revenue from Water Service	<u>(279,862)</u>	<u>(279,861)</u>
Required Revenue Increase	<u>\$ 67,546</u>	<u>\$ 66,979</u>
Percentage Increase	<u>24.14%</u>	<u>23.93%</u>

Signatures



Prepared by: Travis Leach
Revenue Requirements Branch
Division of Financial Analysis



Prepared by: Jason Green
Rate Design Branch
Division of Financial Analysis

APPENDIX

APPENDIX TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2019-00354 DATED **MAR 02 2020**

RATES CALCULATED BY STAFF

Monthly Water Rates

First 2,000 Gallons	\$20.53 Minimum Bill
Next 3,000 Gallons	8.09 per 1,000 Gallons
Next 5,000 Gallons	7.16 per 1,000 Gallons
Next 10,000 Gallons	6.75 per 1,000 Gallons
Over 20,000 Gallons	5.43 per 1,000 Gallons

*Dexter-Almo Heights Water District
351 Almo Road
Almo, KY 42020

*Jasper Wyatt
Dexter-Almo Heights Water District
351 Almo Road
Almo, KY 42020

*Joe Dan Taylor
Commissioner
Dexter-Almo Heights Water District
351 Almo Road
Almo, KY 42020

*Gerald E Wuetcher
Attorney at Law
STOLL KEENON OGDEN PLLC
300 West Vine Street
Suite 2100
Lexington, KENTUCKY 40507-1801